

# Many ISO 9000 certification and maintenance costs now US tax deductible

## In brief

*"Costs incurred by a taxpayer to obtain, maintain, and renew ISO 9000 certification are deductible as ordinary and necessary business expenses," states a new ruling by the US Internal Revenue Service (IRS), that amplifies the range of ISO 9000-related expenses now considered tax deductible.*

The ruling has been described by US tax expert Neil Lonergan as representing "a major change from what had been occurring in IRS field audits". He had been concerned that the IRS would judge consulting fees as a capital expense, and therefore taxable. Now the new ruling "gives manufacturers some comfort that the IRS will not take that approach".

ISO 9000 + ISO 14000  
News reviews IRS Internal Revenue Bulletin (I.R.B.) No. 2000-4, 24 January 2000, which explains the recent ruling relating to Section 162 of the Internal Revenue Code of 1986 - Trade or Business Expenses. By deciding that ISO 9000 certification "does not result in future benefits that are more than incidental" the IRS was able to rule that many of the costs associated with ISO 9000 certification are now deductible for US taxpayers. However, it concluded that if the certification process results in the creation of an asset, costs, such as those incurred in developing a quality manual, are not deductible.

In a recent ruling change of considerable significance to US taxpayers, the US Internal Revenue Service (IRS) has determined that some of the costs of obtaining, renewing and maintaining ISO 9000 certification are now "generally currently deductible".

fees be capitalized because they, in effect, create an intangible asset that has an indefinite life. This ruling gives manufacturers some comfort that the IRS will not take that approach."



The synopsis of the new Revenue Ruling (2000-4) Business expenses; capital expenditures; ISO 9000 costs, highlighted in the Internal Revenue Bulletin (I.R.B.) No. 2000-4, 24 January 2000, states:

"Costs incurred by a taxpayer to obtain, maintain, and renew ISO 9000 certification are deductible as ordinary and necessary business expenses under section 162 of the Code, except to the extent they result in the creation or acquisition of an asset having a useful life substantially beyond the taxable year (e.g., a quality manual). Rev. Proc. 99-49 modified and amplified."

According to Neil Lonergan, a tax partner in professional services organization Grant Thornton LLP<sup>1)</sup>, quoted in a press release issued by the company, the development is significant because it represents a major change from what had been occurring in IRS field audits. "Agents have been arguing that the current deduction is limited to the training component - and that the rest of the costs were to be amortized over the three-year renewal period." Until the new ruling, he added, "we were concerned that the IRS was going to argue that consulting

*Costs incurred by a taxpayer to obtain, maintain, and renew ISO 9000 certification are deductible as ordinary and necessary business expenses*

The question of which ISO 9000-related costs are ruled deductible or held to be capital expenditures is clarified on pages 331-332 of the I.R.B. - Part 1. Rulings and Decisions Under the Internal Revenue Code of 1986. The following extracts define "ISO 9000 costs" and explain the distinction between the various taxable and non-taxable expenditures:

## 'ISO 9000 costs'

"To obtain ISO 9000 certification, an organization may incur internal and external costs to assess its current quality processes, create a quality manual, train its

1) Grant Thornton LLP,  
2E Gilman Street, Madison,  
Wisconsin 53703, USA.  
Tel. + 1 608 257 6761.  
Fax + 1 608 257 6760.

employees, and implement the new quality system. In addition, the organization incurs costs to obtain formal certification from an independent auditor (or "registrar") that its quality management system conforms to a specific ISO 9000 standard. This certification generally lasts from two to four years. After the initial certification, the organization incurs additional costs for periodic audits to maintain its certification and to renew the certification upon expiration of the initial certification period. All these expenditures are referred to herein as 'ISO 9000 costs'."

*ISO 9000 costs are distinguishable from costs incurred to obtain licenses, stock trading privileges, state bar certifications, and similar market-entry requirements*

The I.R.B. comments that although ISO 9000 certification is voluntary, "it increasingly is a contractual requirement for doing business with many organizations, both public and private, worldwide", and is also an alternative to product identification "particularly in the European Union".

### **Tax deduction or capitalization?**

"In determining whether a current deduction or capitalization is the appropriate tax treatment for an expenditure, it is important to consider the extent to which the expenditure will produce future benefits."

Potential benefits of ISO 9000 certification to a US taxpayer are given. For example, it reports that certification may:

- improve the overall quality of the taxpayer's business operations,
- give the taxpayer a marketing advantage by differentiating it from non-certified competitors,



- enable the taxpayer to retain customers that begin requiring their customers to be certified,
- enable the taxpayer to expand its business to new markets and new customers that require their suppliers to be certified.

Although the I.R.B. guideline states that these benefits generally both relate to the current taxable year and extend beyond the taxable year in which the taxpayer obtains ISO 9000 certification, it adds that:

"ISO 9000 certification does not result in future benefits that are more than incidental. The benefits derived from ISO 9000 certification are akin to the current benefits derived from advertising, training, and similar expenditures incurred in operating the taxpayer's business, retaining existing customers, or simply improving the overall quality or attractiveness of the taxpayer's business operations. Although the enhanced marketability of the taxpayer's services or products resulting from ISO 9000 certification may yield future benefits such as repeat business or increased market share, these future benefits are incidental to the primary benefit of current sales. Expenditures that primarily benefit current operations generally are deductible."

Even if ISO 9000 certification facilitates the expansion of the taxpayer's existing business, the I.R.B. comments, the mere ability to sell in new markets and to new customers does not result in significant future benefits. It advises that, because ISO 9000 certification yields only incidental future benefits, "ISO 9000 costs are distinguishable from costs incurred to obtain licenses, stock trading privileges, state bar certifications, and similar market-entry requirements that have been held to be capital expenditures".

*The costs of creating a quality manual (are taxable), even though costs of periodic updates to the manual may be deducted*

### **Taxable elements of the certification process**

While ruling that ISO 9000 certification does not in itself result in the creation of an asset having a useful life substantially beyond the taxable year, the I.R.B. concludes that if the ISO 9000 certification process results in the creation of an asset, the costs allocable must be capitalized, i.e., taxable.

It gives as an example the costs of creating a quality manual, even though costs of periodic updates to the manual may be deducted. "In addition, if the certification process requires the acquisition of an asset, such as machinery and equipment, the costs of that asset must be capitalized under §263(a)." (quoting one of the provisions of the Internal Revenue Code of 1986). □